

ROGER A. BROWN

Lawyer

38 North Washington Street

Post Office Box 475

Phone (209) 533-7755

Sonoma, California 95370

Fax (209) 533-7757

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Sent by fax to 916-322-6440***Original WILL Follow by US Mail***

Chairman Getman and Commissioners Downey, Knox and Swanson
Fair Political Practices Commission
428 J. Street, Suite 450
Sacramento, Ca 95814

RE: *In re Hanko (O-02-088)*

Dear Madame Chairman and Commissioners:

This is to provide the response of the Peninsula Health Care District to the June 26, 2002, staff memorandum to the Commission. Director Hanko will provide her own written comments under separate cover. We received our copy of the memorandum from the staff by fax on July 1, 2002. We would have preferred you receive our comments earlier but the intervening holiday has made that impossible.

It is important at the outset to remind all concerned that this is not an enforcement matter. The District voluntarily requested advice from the Commission. Even though we disagreed with the staff advice and sought reconsideration and then this formal opinion, Director Hanko has followed this erroneous staff advice for over a year. There is not a hint, nor a suggestion, that Director Hanko has done anything wrong. On the contrary, she has shown the highest degree of good faith in all respects.

The District brought these issues to the Commission for advice and an opinion because it is vitally important to the District to have clear, uniform and understandable rules by which to guide their determinations on conflict of interest issues. The District strongly believes that the staff advice received in the Coffey and Brown letters was both incorrect and subjective. As a result, the District could not reasonably tell its board members when they had a potentially disqualifying source of income. The staff analysis prepared at the Commission's direction is just as flawed. While the conclusion to disqualify Director Hanko is clear, the analytical underpinnings are fragile, vague and confusing and based upon a misperception of the facts. The District therefore finds that the staff analysis is no better than the previous advice which could not find a consensus of support among Commissioners at the last hearing.

Our comments about the staff memorandum are both general and specific. We are also concerned about the process and the message this process will send to others who may have questions about the

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application of the Political Reform Act to their own actions in the future. We also highlight and clarify facts which should be considered before reaching a final conclusion on the District's question.

We will point out a number of ambiguities and problems which may make the staff analysis difficult or impossible to implement. We will also argue that if the Commission believes incentive bonus income should be attributed to a customer or a customer of a customer, then it would be more appropriate to amend the current regulations. If the rules are changed in a narrow opinion based only on the facts presented here, there could be major unforeseen consequences on a great many other people with very little public input on the question. This matter could well prove the adage that "Hard cases make bad law."

Facts About The Incentive Bonus

We have previously explained the fact that the bonus is entirely discretionary with Baxter having full control over whether and how much bonus might be paid. Director Hanco receives periodic payment of bonus amounts during the year, based upon Baxter's estimates. However, Baxter makes frequent adjustments of the bonus calculation formula and does not make a final determination of the actual amount of incentive bonus to be paid until several months into the next calendar year. Baxter has also demanded and obtained "refunds" of excess payments from its employees when the year end recalculation showed the person received more in periodic payments that she was entitled to under the final end of year formula. Thus, Director Hanco might be required to return to Baxter amounts already received as progress payments during the previous year. As a result, Director Hanco will not know the final bonus calculation until at least April of the following year.

Director Hanco's bonus is also not based solely on purchases of products by end users such as MPHS over the year. The formula is very complex and it is a proprietary trade secret with Baxter. However, it is generally based upon sales of various product lines as compared with a predetermined budget in various time periods during the year. There is no calculation of bonus based upon sales to particular customers or other end users.

The bonus might not change at all if MPHS were to stop using Baxter products entirely. That is because the patients would go to other providers who would prescribe Baxter products. A much larger factor in determining the amount of bonus is the quality of the Baxter product line and the overall patient load in the geographic area. Patients who need Baxter products will go where they can obtain them. Physicians are the ones who prescribe the drugs used by patients and they typically have privileges at more than one hospital. If MPHS were to forbid using Baxter products, the physician could simply go to a competing hospital to dispense Baxter products or prescribe them from his own office rather than the hospital. Thus, it is the physicians who determine whether and how much of Baxter products will be sold in the geographic area.

If MPHS were to prohibit prescribing Baxter products, the physicians would likely ignore the order. Likewise, if MPHS were to issue an order that only Baxter products may be used, the physicians could ignore that directive as well. Thus, no matter how much contact Director Hanco has with MPHS, her relationship with the individual physicians is much more important than her relationship with MPHS.

It is impossible to tell whether any particular purchase would have any effect on the amount of Director Hanks's bonus. Any given transaction could increase, decrease, or have no effect at all on her income. It is the aggregate of all sales transactions for multiple product lines in a given time period for an entire territory as compared to certain budgets and goals (all of which are completely beyond her control) which, along with the overall profitability of the company combine to determine the incentive bonus income. These complicated formulae are typically changed by Baxter at least once each year.

Any estimated attribution to MPHS or any other direct or indirect purchaser must await data which is compiled by a third party and provided to Baxter after the close of the calendar year. This estimated attribution is not contained in any of the third party data, but is the result of estimates, guesses and speculation by Director Hanks from the data provided. The attribution estimate is a very rough number and no effort has been made to make this estimate for 2001 or 2002 incentive bonus income, because Director Hanks is still disqualifying herself pursuant to staff advice. Further, Director Hanks still does not have the final bonus calculation for 2001 from Baxter and until then, she has no legal "right" to any of these funds.

As the staff has noted, the incentive bonus is not based on individual sales of specific products. Director Hanks does not know when MPHS or any other medical provider makes a purchase of Baxter products. As a result, under the staff's analysis, Director Hanks will never know when a customer or a customer of a customer has purchased sufficient products above the bonus threshold to provide her with any bonus at all. It is even more difficult for Director Hanks to estimate whether or when any provider has purchased sufficient product so that it will "cause" Director Hanks to cross the threshold into bonus income.

The staff has mischaracterized some of the facts. Staff repeatedly refers to MPHS as the customer of Baxter. MPHS does not purchase directly from Baxter. MPHS is the customer of a customer of Baxter and is thus three steps removed from Director Hanks. MPHS buys Baxter products from an independent third party wholesaler, not from Baxter.

The staff also incorrectly concludes, "There is clearly a direct salesperson/customer relationship between Director Hanks and MPHS." (Staff memo, p. 5.)¹ We have repeatedly pointed out that Director Hanks spends her time and efforts educating physicians, nurses and related medical providers about Baxter products and that the physicians are the ones who select which product to prescribe, not the hospital. Further, Director Hanks is engaged in absolutely no direct selling to MPHS or anyone else. Finally, MPHS is not a customer of Baxter. Thus, contrary to the staff conclusion, Director Hanks does not have a direct salesperson/customer relationship with MPHS. The staff conclusion lacks any factual support.

Staff claims that if MPHS discontinued using Baxter products, "it is reasonable to assume that there would be a decline in Baxter's sales directly attributable to the loss of MPHS as a purchaser. No one has asserted this is not the case." (Staff memo, p. 5.) Staff is incorrect. First, MPHS does not have the authority to direct an independent physician (who simply has hospital privileges with MPHS) to

¹ It has long been noted by legal observers that whenever a lawyer uses the word "clearly" it indicates that there is nothing whatever clear about the matter.

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stop prescribing a Baxter product. This would interfere with the independent medical judgment of the physician and would impermissibly interfere with the doctor-patient relationship. Further, if the physician believes the Baxter product is superior, that is the product which will be prescribed. When such prescriptions are filled at the hospital pharmacy, they will be refilled by MPHS orders with the independent third party wholesaler. This is hardly a direct attribution of sales to MPHS.

Also, Director Hanco directly refuted this flawed conclusion by stating that if the patient mix changes at MPHS or for that matter, if MPHS goes out of business entirely, her bonus income would probably not be affected at all. The same would be true if the board decided to refocus the hospital's attention to a particular segment of the patient population. That is because the patients' needs and their physicians' prescriptions drive the purchases of Baxter products, not the hospital's buying decisions. If the patients or their physicians cannot go to MPHS, they will go to another hospital. Since Director Hanco's territory extends from San Francisco to Santa Cruz, it is likely that the patients would use and their doctors would prescribe the same amount of Baxter products and her bonus would not be impacted at all.

The staff is also mistaken when they state, "Based on the success or failure of Ms. Hanco in this direct salesperson/customer relationship between Director Hanco and MPHS, a bonus is generated." (Staff memo, p. 5.) The staff bases their conclusion on faulty assumptions and the conclusion is erroneous. As noted elsewhere in this reply, there is no direct relationship between MPHS purchases and the amount of bonus Director Hanco receives. There is at best, a very indirect, discretionary, and complex calculus which permits a very rough estimate of the amount of bonus which could be associated with MPHS. The bonus follows a very complicated formula which uses various products lines, goals, budgets, shifting time periods for the entire geographic area and overall company profitability to determine the amount of bonus. It is Director Hanco's success with all doctors, nurses, and other medical providers in her entire territory which tends to generate a bonus, not her success with MPHS.

Similarly, the staff is incorrect when they state, without factual support, that if MPHS doubled its purchases of Baxter products, Director Hanco's bonus would increase accordingly. Again, Baxter products are selected by patients and physicians, not by the hospital. The hospital simply buys product to replace those sold to patients by the pharmacy or used by physicians for treating patients on site. There are only so many patients in the area. Whether these patients go to MPHS or another hospital will not have any effect on Director Hanco's bonus because she earns a bonus based, in part, on sales in the entire geographic area by all buyers combined.

The staff has made erroneous assumptions which lead to faulty conclusions in an effort to justify the result which the Commission has instructed them to reach. Many of the erroneous conclusions stated by the staff betray a desperate attempt to find some basis to disqualify Director Hanco. This is a very dangerous process which may set a very inappropriate precedent for Commission decision making. The ad hoc nature of the process also makes it very difficult for the District to extrapolate the rules to other directors whose sources of income may require similar analysis.

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Process

From the outset we have been troubled by the manner in which Director Hanko has been disqualified. The District voluntarily brought this matter to the staff for advice. Thus, we are here at the request of the District for guidance on the proper interpretation of the law, not as respondents in an enforcement matter. The staff advised that Ms. Hanko had a financial interest in MPHS, even though that conclusion was not apparent from the statute, the regulation or the prior advice letters on which the staff relied. While we disagreed with this conclusion, Director Hanko followed staff advice and has continued to disqualify herself for over a year. When we were unable to persuade staff to change their conclusion on reconsideration, we brought this matter to the full commission for an opinion.

At the first hearing on the opinion request, the commission was unable to reach any consensus on whether the prior staff analysis was correct. The commission was unable to agree on what the rules are or should be with respect to the questions presented. When the rules are so difficult that the Commission is unable to agree on them, what hope does a public official have to discern them? The only consensus we could glean from the last hearing was the conclusion that Director Hanko *should* be disqualified from decisions materially affecting MPHS, but without articulating what rules led to this conclusion.

To an objective outside observer, this process might appear to have placed the cart before the horse. Director Hanko was disqualified before anybody could agree on the rules which might require her disqualification. The staff was sent back to come up with an analysis to justify the decision. We agree with Commissioner Knox who stated that it is not fair to tell the staff to find a justification for the desired result. Commissioner Knox supported a new and different analysis, but did not support "preordaining the result of the analysis." (Draft Minutes, June 7, 2002, Commission Hearing, p. 10.) We contend the more appropriate process would have been to articulate rules of general application and then compare the Hanko facts to these rules to determine what result should ensue. That is the normal manner in which the rule of law is intended to work.

Further, at least two Commissioners seemed troubled by Director Hanko's understandable reluctance to reveal more about her personal finances than was necessary to resolve the question pending before the Commission. Director Hanko stipulated that the amount of her incentive bonus which she estimated to be attributable to MPHS was in excess of the disqualification threshold, and accordingly, *if* MPHS was a "source of income," then such income is potentially disqualifying. The real question here is *whether* MPHS is a source of income, not the amount of such income. Accordingly, the stipulation was sufficient to focus the analysis on the source of income question. Since the amount was above the disqualification threshold, it would not matter whether the excess was a little or a lot.

It is beyond dispute that a public official, like any other citizen of this state, has a fundamental right to privacy in her personal financial information. (*Hays v. Wood* (1979) 25 Cal.3d 772; *County of Nevada v. MacMillen* (1974) 11 Cal.3d 662; *Carmel by the Sea v. Young* (1970) 2 Cal.3d 259.) Further, "...the power of government, federal or state, to withhold benefits from its citizens does not encompass a supposed 'lesser' power to grant such benefits upon an arbitrary deprivation of constitutional right." (*Carmel by the Sea v. Young, supra*, at p. 265.) Thus, while we understand the Commissioners' curiosity, Director Hanko has not waived or given up her legitimate right to financial

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privacy by the mere act of requesting an opinion from the Commission. Director Hanko's reluctance to provide the exact amount of incentive bonus she received, cannot and should not be used against her, because she is simply asserting her constitutional rights. Further, Director Hanko should not be required to relinquish such an important constitutional right in order to receive the benefit of the Commission's objective interpretation of the law, especially where the information is not material to the analysis or the result.

In striking down a previous legislative attempt to require personal financial disclosure by public officials, the Supreme Court explained in *Carmel by the Sea v. Young*, *supra*, at p.263:

The familiar rule is that a governmental purpose to control or prevent activities constitutionally subject to state regulation may not be achieved by means which sweep unnecessarily broadly and thereby invade the area of protected freedoms. Even though the governmental purpose be legitimate and substantial, that purpose cannot be pursued by means that broadly stifle fundamental personal liberties when the end can be more narrowly achieved. (Citations and internal quotation marks omitted.)

In *Hays v. Wood* (1979) 25 Cal.3d 772, 782, the court approved the financial disclosure provisions of the Political Reform Act of 1974 which, "...seek appropriate information about the sources and *general magnitude* of financial interest which may give rise to conflict of interest, but *refrain from prying unnecessarily into their exact nature and amount*." (Emphasis added.)

In *County of Nevada v. MacMillen* (1974) 11 Cal.3d 662, the Supreme Court reviewed the financial disclosure statute which preceded the enactment of the Political Reform Act, former Government Code sections 3600 et seq. With respect to personal financial disclosure, these provisions were similar to the Political Reform Act.

The *County of Nevada* decision upheld these disclosure provisions. In so doing, the court distinguished the 1973 law from its 1969 predecessor (struck down in *Carmel by the Sea v. Young*, *supra*, 2 Cal.3d 259.) stating that, "...unlike the 1969 act, the 1973 act does not require disclosure of the actual extent of the official's assets and interest, but only whether the value of his investment or real property interest exceeds \$10,000 (and whether the aggregate value of income, loans and gifts during the year exceeded \$1,000)." (*County of Nevada v. MacMillen*, *supra*, at pp. 672-673.) As a result, the court held that there were sufficient assurances against unwarranted intrusion into protected areas of personal privacy to uphold the act.

Director Hanko's stipulation about the amount of her incentive bonus attributable to MPHS business is sufficient for the commission to render an opinion and any more precision would "sweep unnecessarily broadly...when the end can be more narrowly achieved." (*Carmel by the Sea v. Young*, *supra*, at p.263.) Moreover, it would be improper for the Commission to punish Director Hanko for the assertion of her constitutional rights or to make any negative inferences from her assertion of these rights. The District has forthrightly provided all material information necessary for the Commission to issue an opinion.

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Scope of the Opinion

We are also troubled by the scope and kind of analysis provided by the staff. While we understand that staff was responding to specific direction from the Commission, it appears to us that instead of interpreting the Act and the regulations currently in force, the staff is being asked to provide the Commission with an analysis supporting *expansion of the law* into new areas not currently governed by the statute or regulations.

The staff has suggested an entirely new extension of the concept of "source of income" for a new class of persons: those who receive incentive bonus income under certain circumstances. We believe this extension of the law should be done, if at all, only through legislation or the rule making process. That is how the current "source of commission income" regulation (Regulation 18703.3(c)) came to be. That is also how any *extension* of the rule should be enacted, if at all.

For these reasons, we believe the Commission should decline to adopt the staff analysis and place this matter on their regulation calendar for the normal process of considering and adopting rules of general application. Further, since there is no consensus in support of the existing staff advice, that advice should be rescinded. We fear that an attempt to fashion a special rule to fit the Hanco situation will have unforeseen and unintended consequences which could make the solution worse than the perceived problem. The Commission has already expressed concern about the application of the rule to bonus income received by attorneys from their law firms and we fear there may be many other examples of such unintended consequences which might only be brought to light through the rule making process.

Accordingly, we suggest that if the Commission wishes to expand the definition of "source of income" to persons not currently covered by the statute and regulation, it should do so by either sponsoring legislation or by initiating the rule making process toward the adoption of a new regulation. We believe it is dangerous to expand the law through the opinion process.

The Staff Analysis is Flawed

The staff has proposed three tests, all of which must be present, for finding that anyone other than the employer is a source of incentive bonus income. Staff proposes that income be attributed to the customer of an employer² where the official: 1) has purposefully directed sales or marketing activity toward the customer (see footnote 2 below); 2) there is direct contact between the official and the customer intended to generate sales or business; and 3) there is a direct relationship between the purchasing activity of the customer and the amount of the incentive compensation received by the public official. We believe these elements of analysis will cause more problems than they will solve and they help illustrate why the Commission should not extend the reach of the source of income rules without a great deal more public input and reflection.

² It should be noted here and elsewhere that MPHS is the customer of a customer of the employer. We will argue *infra* that the Commission should place some reasonable limit on how far from the actual payor the source of income concept will be pursued. We believe the customer of a customer of an employer has already passed the limits of reason and good public policy.

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A. Purposeful Directed Sales Activity. One of the problems of this analysis is that it injects new concepts into the mix which are themselves ambiguous. What is "purposeful directed sales activity?" How can some other public official determine what is meant by this concept without guessing as to its real meaning? Must the purposeful sales activity be directed at MPHS itself? Is marketing and educational effort directed at doctors, who are not employees of MPHS, considered purposeful directed sales activity? Is it purposeful directed sales activity for Director Hanko to educate non-employee physicians about the virtues of Baxter products without urging them to buy or to prescribe them? Even if Director Hanko urges a non-employee physician to prescribe a Baxter product, is that activity purposefully directed at MPHS? Is it the subjective intent of the official or her objective actions which must manifest this purposeful directed sales activity? Is this intended to be a broadly inclusive concept or a narrow one?

Since the staff analysis proposes an extension of the source of income attribution rules, it will be necessary for all public officials who receive bonus income to review these rules to determine whether they also have remote "sources of income" from the receipt of such bonus income. Since such officials will not know and cannot glean from this staff analysis what is meant by "purposeful directed sales activity" they are left to guess at the true scope and limits of the rule. One thing is clear to us: This concept will sweep up most or all attorneys who receive bonus income from their law firms.

To use the Chairman's example, if an attorney contacts a client or prospective client to obtain additional work for the firm, and if that attorney receives a bonus which can be traced directly or indirectly to the client, is that client a source of income? Despite staff belief to the contrary, *every* attorney in private practice is encouraged to market the practice in every imaginable context. Every social, business and community contact is considered a potential marketing opportunity. Young lawyers in private practice are taught to use all their contacts to market their firm's services. *Every* client contact is a marketing opportunity and those attorneys who neglect this activity will typically receive a smaller bonus than those who recognize and pursue these opportunities.

The staff is simply wrong when they claim that an attorney associate's activity would not be "purposefully directed" toward a client in order to increase the number of billable hours. It is naive to believe that attorneys in private practice are not constantly marketing their practice with the purpose of growing their business. If they get a bonus, then under the staff analysis, these attorneys will be subject to disqualification. The staff's assumptions and conclusion about purposefully directed activity at a law firm further illustrate the unworkability of their analysis.

Another attorney example may be found with those who practice insurance defense work. In this kind of work, the actual client is the individual insured. However, that person does not actually pay the attorney, it is the insurance company who pays the bills. The attorney will have direct contact with the insurance company and the client, but marketing will typically be directed at the insurance company and its adjusters. Under the staff analysis, would the client be a source of bonus income, or would the insurance company be the source, or both? If the client is considered a source of income, how can the staff justify this result when the client pays nothing for the representation? The attorney's attempts to get more business from the adjuster, coupled with purposeful direct contacts with that adjuster and the receipt of bonus income traceable to the adjuster, would make the insurance company a source of bonus income under the staff analysis.

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B. Direct Contact With Customer. Staff argues that direct contact with the customer is very important to its conclusion that MPHS is a source of income to Director Hanko. For example, staff contends that if Director Hanko received bonus income based upon the efforts of her entire team, with no personal contact between MPHS and Director Hanko herself, then MPHS would *not* be a source of income. This analysis begs further questions.

How much direct contact is necessary between Director Hanko and MPHS? We have already stated that most of the direct contact is between Director Hanko and the physicians (who are not employed by MPHS). Physicians make prescribing decisions, not MPHS. So if a majority of direct contacts are with someone other than MPHS, does that remove the link and break the attribution? Is a single direct contact with MPHS enough to trigger these attribution rules? Must this activity be in person, or will direct mail, email, fax or telephone contact be sufficient? And since Director Hanko has no direct contact with the third party independent warehouse, who is the actual customer of Baxter, does that break the links in the chain of attribution?

In another context, does a product repair person make direct contact with a customer? If the repair person tries to sell an improved model or even a replacement part, does that qualify the customer as a source of income if the repair person gets an annual bonus based on aggregate sales? If an attorney associate attends a client conference, is that a direct contact as well? There are so many related questions of frequency, context, relationship and purpose that the notion of direct contact as a qualifying element becomes overly complex and meaningless.

The staff inaccurately concludes that, "Director Hanko's employer apparently assumes that sales to MPHS can be increased through her efforts and, therefore, pays her additional compensation for performing her job well with respect to that particular client. Therefore, direct contact with the person to whom the incentive compensation is attributed is important." (Staff memo, p. 9.) These are not facts, they are erroneous assumptions and conclusions. There is absolutely no evidentiary or factual support for these staff conclusions. Director Hanko does not receive additional compensation for increased sales to MPHS. She receives a bonus based upon a very complex formula, but whether MPHS buys any Baxter products whatever, would have little if any effect on the amount of Director Hanko's bonus for the reasons set out above.

C. Direct Relationship Between Purchase and Amount of Bonus. The relationship between Director Hanko's bonus and MPHS purchases is indirect at best. It is more accurately described as convoluted, complex and discretionary. The facts simply do not support the staff conclusion that the bonus is "directly related" to the purchasing activity of MPHS. As we have explained, if MPHS closed its doors tomorrow, Director Hanko would probably not lose any of her bonus income, because those doctors and patients will go to another hospital in the area. If the doctor believes a Baxter product is best for the patient, that is what they will get, whether at MPHS or elsewhere.

While the staff repeats its assumptions about the direct relationship, repetition does not make them true. Unfortunately, reality is seldom tidy and this matter is no different. The complex and discretionary nature of the bonus calculation makes it almost impossible to find a direct link between MPHS purchases and the amount of Director Hanko's bonus income. The direct relationship is with overall sales of certain Baxter products in the territory, for certain periods within the year, as compared

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to budgets and goals and with consideration for overall Baxter profitability during the period, all as adjusted from time to time during the year and after the year is over.

Other Problems Raised by the Staff Analysis

If the staff analysis is adopted without widespread public and public official input (as in the regulatory adoption process) then there is a real danger that the Commission will be opening a "Pandora's Box" of unforeseen problems. We have already pointed out the attorney/public official problem, but there are others.

The staff analysis gives great weight to "The public official's knowledge of the source of income...." (Staff memo, p. 8.) The real question here is: "Knowledge of what?" Is it knowledge that MPHS purchases Baxter products? Or that Baxter uses the volume of sales of their products to all purchasers, including MPHS, in making their bonus calculation? Or knowledge of the amount of the bonus that is attributable to MPHS purchases of product through an independent third party wholesaler? Further, is knowledge intended to be concrete and factual, or is it guesswork, speculation and estimation which the staff intends to include? How hard must the District tell its directors to work to acquire whatever "knowledge" the staff analysis requires?

In this matter, Director Hanco did not have information (i.e. "Knowledge") from her employer or from MPHS which would reveal the amount of her bonus that could be attributed to MPHS under any set of rules. This suggests a lack of knowledge. In an exercise of good faith, Director Hanco obtained data from a third party, compared it to additional data she obtained from her employer, and she then made a series of assumptions and guesses to arrive at her estimate of the amount of her bonus that might be attributed to MPHS purchases of Baxter products. This exercise was arduous, time consuming and imprecise. It yielded a very rough estimate which the District provided to the Commission. To what extent are public officials required to repeat this kind of difficult analysis to disqualify themselves? And what of the official who says, "I do not have that information and it is too difficult for me to estimate." Are other public officials expected to go to the same lengths of analysis, calculation and speculation as Director Hanco to estimate the amount of income that might be indirectly attributable to the purchases of a customer of a customer?

Put another way, may a public official simply rely upon the data which is available or must she create a new data set and engage in complex analysis to estimate the amount of income which might be attributable to a particular customer of a customer? We think it is unlikely that other public officials would have gone to the same effort as occurred here and we wonder whether Director Hanco went further than the law requires. Is a reasonable, good faith estimate of amounts and values sufficient for a public official to discharge this responsibility? If the official does not go to heroic efforts to estimate the income to be attributed, what is to be done? Is the official charged with the information she would have discovered *if* the analysis had been performed? Is it actual knowledge which the rule would require or does the staff believe there should be a "*should have known*" standard?

Also, under the staff analysis, when will Director Hanco have reached the disqualification threshold with respect to MPHS and how will she know it? As we stated, it is impossible for Director Hanco even to know the exact amount of bonus she will keep for the year until at least a third of the

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way through the following year. It is likewise impossible to estimate the amount of her bonus that might be attributable to MPHS under any rules, until sometime later. Accordingly, when will Director Hanko *first* be disqualified during the year? We understand there is a 12 month disqualification period following receipt of the income, but when does that period begin to run and when does it end under the facts of this opinion request and the staff analysis?

Since the estimated amount of bonus attributable to MPHS will not be known until well after the year in which it is received, will the Commission provide some safety valve mechanism to permit the public official to eliminate the conflict? In earlier letters the staff suggested the possibility that the amount attributed to MPHS might be returned to the employer or perhaps it might be donated to charity or some other worthwhile cause. In any event, it would seem unfair not to provide an escape route for a public official who inadvertently finds herself disqualified by virtue of a source of income she did not know she had.

It may be useful to recall the examples cited by staff in an earlier memo to the Commission concerning the possibility that some people might try to manufacture a disqualification to serve their own selfish interests. Will the adoption of the staff analysis lead to "gaming" the disqualification of Director Hanko by a purported source of income in order to assure that she cannot participate in decisions affecting them? Is it possible that a customer might actually increase their purchases of Baxter products to ensure the disqualification of Director Hanko? Unfortunately, the staff analysis would, if adopted by the Commission, permit a customer of a customer to force the disqualification of Director Hanko by the simple device of purchasing more Baxter products. That result is not good public policy and such an unsavory result should be avoided.

How many steps beyond the actual payor must the public official look for a potentially disqualifying source of income? In this matter, the staff has looked to the employer, skipped the third party independent wholesaler, then looked to the customer of a customer (MPHS). Must Director Hanko also look beyond MPHS? What of the physicians who actually prescribe the products, or the patients who use them? There must be a limit to how far a public official must reasonably look for such conflicts of interest. The further away from the actual payor, the less need to protect the public from real or imagined conflicts of interest. In any event, the Commission must articulate *some limitation* on the inquiry, or public officials throughout the state may find themselves disqualified where they had no idea they even had a financial interest.

Also, what does this whole process say to other public officials who may be wondering whether to ask for staff advice? Good public policy would encourage people to seek and follow sound staff advice. However, in this matter, the staff used the occasion to expand the source of income rules and the Commission is considering a further expansion. What would have happened if the District had not sought staff advice in the first place? First, Director Hanko would probably not have done the complex analysis which resulted in her estimate of income attributable to MPHS. Next, since neither the statute nor Regulation 18703.3 address her situation, if she had cast votes and participated in governmental decisions affecting MPHS, it is unlikely that the enforcement division or anyone else could have brought enforcement action against her. The clear message to others is that they should not ask for Commission assistance unless they want to be disqualified.

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We believe that the Commission and the staff should use the advice and opinion process to interpret existing law, not to create new law nor to extend the law into new uncharted waters. That exercise is better left to the legislative and rule making process. After what she has been through, it would be very hard for Director Hanko to recommend to any other public official that they seek FPPC advice before casting a vote. Director Hanko has followed what we contend is erroneous staff advice for over a year and during that time, her constituents have been essentially without representation. It would be very hard to encourage others to follow this example.

Conclusion

We have shown the utmost good faith in seeking Commission assistance. Director Hanko performed difficult calculations and estimates to provide the Commission with information relevant to these issues. She has stipulated that the amount of her bonus income which might be attributable to MPHS exceeds the threshold for disqualification, if, and only if, MPHS is deemed to be a source of income. Significantly, Director Hanko has disqualified herself from governmental decisions in accord with staff advice for over a year.

We contend that the statute and Regulation 18703.3(a) provide all the guidance the Commission needs to issue an opinion which properly concludes that under the facts provided, MPHS is not a source of income to Director Hanko. There is no good policy reason to expand the concept of source of income two or three levels beyond the public official. At some point, the inquiry must end. We believe the Act and the Regulation compel the conclusion that unless the income is a true "commission" as defined in Regulation 18703.3(c), it is only the actual payor who is the source of income.

If the Commission wants to expand the definition of "commission" they should do so by amending the Regulation which defines the term, not by issuing an opinion which changes the Regulation. If the Commission believes the statute is insufficiently clear, they should sponsor clarifying legislation. The Commission has sponsored many bills in the past and this exercise would be no different.

However, since the Commissioners themselves cannot agree upon what rules govern Director Hanko's situation, there is not a sufficient consensus to ratify prior staff advice. Thus, prior staff advice should be rescinded and disapproved.

Further, unless the Commission can find a consensus for some interpretation of the term "source of income" which applies to the receipt of bonus income by Director Hanko, the opinion should find that Director Hanko has no disqualifying conflict of interest in MPHS because under the statute and the Regulation, MPHS is not a source of income.

It is also important for the credibility and continued moral authority of the Commission that the process be seen as fair and that it actually be fair. We do not think it fair for the Commission to say Director Hanko has a disqualifying conflict of interest when the rules leading to that result have not yet been devised. As Commissioner Knox pointed out, it is not fair to decide the matter and then tell staff to go find a reason to support the result.

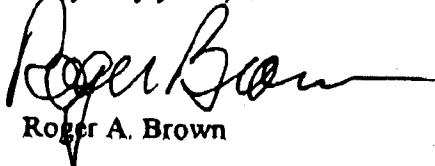
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We believe the Commission should rescind staff advice in this matter and provide an opinion of what the law *is* rather than what it *should be*. We also believe that the proper course, if the Commission wants to expand the definition of "source of income," is to begin the rule making process by noticing a new Regulation or an amendment to the existing Regulation 18703.3. That process would encourage maximum public participation. That process would also set the rules of general application first, rather than disqualifying someone and then searching for an analysis or justification for doing so.

However, if the Commission adopts a new interpretation of the source of income rules, it should be narrow, specific, unambiguous and it should provide a bright line to guide Director Hanko, the District, and all other public officials in determining exactly when and under what circumstances their receipt of bonus compensation will be attributed to someone other than the actual payor. The Commission should adopt rules that cannot be "gamed" by a customer of a customer to manufacture a disqualification. The new rules should also tell officials just how far they must go in estimating the amounts attributable to customers and customers of customers. These new rules should have some reasonable limits on how many levels the official must try to follow the source. Finally, the rules should be clear enough that ordinary people of common intelligence can apply them. The analysis suggested by the staff does none of these things and as a result, we believe adoption of that analysis will do more harm than good.

Very truly yours,


Roger A. Brown

RAB/hs

cc: Colin Coffey